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A poisonous mix for the economy
Data show prices shooting up while growth is slowing down

By Dean Calbreath
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It's been three decades since the nation suffered its last bout of stagflation: a combination of stagnant economic growth, rampant inflation and rising unemployment.

But with consumer prices shooting up and the threat of recession looming, many economists warn that another round of stagflation may be on the horizon. Even if stagflation can be avoided, it seems likely that the economy will worsen over the near future, they say.

“Each day, inflation is getting to be more of a nasty problem,” said Dan Seiver, a finance professor at San Diego State University. “And economic growth, which slowed to nearly zero in the fourth quarter of last year, could easily dip below zero this quarter. So we're getting the 'stag' part of stagflation, too.”

A flurry of economic data yesterday contained mounting evidence that inflation is rising while the economy is weakening.

▪The producer price index, which measures wholesale prices of raw materials, increased 1 percent in January when including prices of food and energy. The core index, which excludes food and energy, increased 0.4 percent – twice as high as the forecast. That means higher prices for consumers.

▪The price of crude oil briefly touched $101.15 a barrel yesterday, nearing the inflation-adjusted all-time high of $102.53 in 1980. The hike suggests there may be inflationary pressures on petroleum-based items such as plastics, polyester and fertilizer.

▪Housing, which has become one of the chief drags on economic growth, continued its long-running decline. The Standard & Poor's Case-Shiller index released yesterday showed that prices in the nation's top metro areas dropped more than 9 percent between December 2006 and December 2007, including a 15 percent drop in San Diego. The national decline was the steepest year-to-year drop in the index's 20-year history.

- Nationwide, the number of mortgage defaults and home foreclosures jumped 57 percent between January 2007 and January 2008, according to a report from RealtyTrac, a real estate data agency in Irvine.

- Consumer confidence plunged to its lowest level since February 2003 when the nation was on the brink of invading Iraq, according to New York's Conference Board, a research group sponsored by some of the nation's leading corporations. When consumers lack confidence in the economy, they tend to spend less money on big-ticket items.

“We have stagflation,” said Peter Schiff, head of Euro Pacific Capital in Newport Beach. “No matter what the government numbers say, we're in a recession already, especially if you measure our growth against foreign currencies or gold. And even by the government's figures, we clearly have very high inflation – and the government data really don't capture the extent of how prices are rising.”

Ross Starr, an economist at the University of California San Diego, said the economy probably slipped into a recession late last year that will continue through the summer. He doubts that prices will rise enough to result in stagflation, but that could change if salaries begin to rise along with the price of consumer goods.

“What the Federal Reserve is worried about is that people will start drawing up their labor contracts to reflect future increases in consumer prices,” he said.

So far, one area in which the economy has shown less weakness is unemployment. While the jobless rate has been rising – approaching 5 percent nationwide and in San Diego County – that's far below the double-digit rates of previous recessions.

The last time the United States suffered stagflation was the 1970s, following a hike in the price of oil by the Organization of Petroleum Exporting Countries, or OPEC. As inflation surged, President Nixon imposed controls on wages and prices, which dramatically slowed economic growth.

Once the controls were lifted, inflation reached double-digit levels, prompting President Ford to start the WIN campaign: “Whip Inflation Now.” Inflation continued to haunt the economy until the late 1970s, when the Federal Reserve rose interest rates under President Carter. The Fed's actions quashed inflation but also threw the economy into a severe recession.

“Stagflation was cured by the worst recession in 50 years,” Starr said. “Fortunately, the situation now is certainly much calmer and inflation rates are much lower.”

The U.S. Labor Department's latest reading showed consumer prices up 4.3 percent over the last year. But Peter Morici, an economist at the University of Maryland, warns that inflation may rise over the next year, particularly because China is also dealing with inflation. As prices of China's goods rise, U.S. consumer prices will increase and result in a bout of stagflation, Morici said.

Morici blamed lax banking policies, which fed the housing bubble of the early 2000s, and trade policies that made the economy too dependent on exports.

He said the rise of stagflation has spelled an end to the “Goldilocks economy” engineered by former Fed Chairman Alan Greenspan – in which economic growth and inflation were not allowed to grow too hot or too cold.

“The Goldilocks economy is over,” Morici said. “What we've got is the purgatory economy, where sinners go to seek redemption.”